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European Implications of Bankruptcy Venue Shopping in the U.S.

DAVID A. SKEEL, JR.†

INTRODUCTION

For decades, the U.S. debate over states' efforts to attract corporations—and over Delaware's success in that endeavor—was mostly a sideshow for European companies and scholars. To be sure, there have long been worries that charter competition might emerge in the European Union and generate a regulatory “race to the bottom.”¹ But the “real seat” doctrine, which assured that the country where a corporation's principal operations are located would supply its corporate law, was strongly entrenched. Whereas U.S. companies that would prefer a different regulatory framework need only reincorporate in the jurisdiction they wish to be governed by, European companies were stuck with the laws of the country where most of their operations were located. As a result, European companies did not have a dog in the U.S. skirmishes over charter competition in corporate law and venue shopping in corporate bankruptcy.²

† S. Samuel Arsht Professor of Corporate Law, University of Pennsylvania. Thanks to Bill Whitford for setting up this symposium, and to Horst Eidenmuller, Luca Enriques, and Lynn LoPucki for helpful comments on an earlier draft. Although I reach very different conclusions than LoPucki about the significance of bankruptcy venue shopping, I am a great admirer of his work, and a longtime beneficiary of his insights, his Bankruptcy Research Database, and his friendship.

1. Concerns about charter competition were one impetus for longstanding efforts to promote harmonization of EU members' corporate laws. *See, e.g.*, VANESSA EDWARDS, *EC COMPANY LAW* 3 (1999).

2. The well-spring of the recent corporate charter debate was William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 *YALE L.J.* 663 (1974), which castigated Delaware as a “pigmy state” and called for

Suddenly, everything has changed. Starting with the Centros case in 1999, EU courts have issued a series of decisions suggesting that a company's corporate laws will be determined by its domicile, even if most or all of the company's assets and operations are located elsewhere.³ This means that a French or German company can incorporate in England to take advantage of English corporate law, much as roughly half of the Fortune 500 companies incorporate in Delaware to assure access to Delaware law and the privileges of Delaware incorporation.⁴ The EU does not invite the same kind of forum shopping in the insolvency context. But a recent EU Insolvency Regulation that requires insolvency proceedings to be held in a company's "centre of main interests"—or COMI—is seen as sufficiently "fuzzy" to allow at least limited forum shopping when a company encounters financial distress.

Thanks to these developments, regulatory competition is now more of a reality in the EU than ever before. Increasingly, European scholars are glancing across the

increased federalization of corporate law. Professor LoPucki and his co-author Bill Whitford were the first to shine a light on venue shopping in corporate reorganization cases. See Lynn M. LoPucki & William C. Whitford, *Venue Choice and Forum Shopping in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 1991 WIS. L. REV. 11. Both debates have historical antecedents that go back even further. See, e.g., David A. Skeel, Jr., *Bankruptcy Judges and Bankruptcy Venue: Some Thoughts on Delaware*, 1 DEL. L. REV. 1, 8-11 (1998) (describing New Deal debates over Delaware's prominence as a court of choice for reorganization cases).

3. Case C-212/97, *Centros Ltd v. Erhvervs- og Selskabsstyrelsen*, (Mar. 9, 1999) (Den.), <http://europa.eu.int/eur-lex/lex/LexUriServ/LexUriServ.do?uri=CELEX:61997J0212:EN:HTML>. The central holding of *Centros* was reaffirmed in the subsequent *Überseering* and *Inspire Art* decisions. See Case C-208/00, *Überseering BV v. Nordic Construction Company Baumanagement GmbH (NCC)* (Nov. 9, 2002) (F.R.G.), <http://europa.eu.int/eur-lex/lex/LexUriServ/LexUriServ.do?uri=CELEX:62000J0208:EN:HTML>; Case C-167/01, *Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd.* (Sep. 30, 2003) (Neth.), <http://europa.eu.int/eurlex/lex/LexUriServ/LexUriServ.do?uri=CELEX:62001J0167:EN:HTML>.

4. European companies currently have much more flexibility to choose their domicile at the formation stage than midstream, due to tax and other barriers that impede reincorporation. For a persuasive argument that many of these barriers are likely to fall in the near future, see John Armour, *Who Should Make Corporate Law? EU Legislation versus Regulatory Competition* (ESRC Ctr. for Bus. Research, Univ. of Cambridge, Working Paper No. 307, 2005), available at <http://www.cbr.cam.ac.uk/pdf/WP307.pdf>.

Atlantic to see what can be gleaned from the longstanding American debates on these questions. What does the American evidence tell us?

When it comes to the bankruptcy side of the equation—and in particular, Delaware's status as the venue of choice for large corporate bankruptcies in the 1990s—Lynn LoPucki offers a simple, decisive answer in *Courting Failure*.⁵ Not to put too fine a point on it, LoPucki insists—"shouts" might be a better word—that venue shopping in U.S. bankruptcy cases is a plague that spreads the disease of corruption wherever it goes. The Delaware bankruptcy judges attracted many of the largest corporate reorganization cases in the 1990s by allowing failed managers to remain in charge and inviting their bankruptcy lawyers to line their own pockets in order to entice the managers and lawyers to bring the cases in Delaware. The process that emerged, LoPucki contends, was rotten to the core.⁶ Since then, he argues, other bankruptcy courts have adopted the same corrupt practices, hoping to attract some of the large cases for themselves. LoPucki believes that this corruption has now crossed the Atlantic and is infecting Europe.⁷ The new EU Insolvency Regulation, together with a general move toward "universalism" in international insolvency cases, has unleashed in Europe the same plague that has ravished the U.S. system.⁸ The only response, he contends, is a quarantine that requires that a separate, primary insolvency proceeding be brought in each country where a company's assets or operations are located.⁹ This response,

5. LYNN M. LOPUCKI, *COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS* (2005).

6. Much of the debate surrounding *Courting Failure* has involved LoPucki's suggestion that the Delaware judges and other bankruptcy judges who have adopted similar practices are "corrupt." Two of the contributions to this symposium offer detailed and persuasive analyses of the corruption rhetoric and its implications. A. Mechele Dickerson, *Words that Wound: Defining, Discussing and Defeating Bankruptcy "Corruption,"* 54 BUFF. L. REV. 365 (2006); Charles J. Tabb, *Courting Controversy*, 54 BUFF. L. REV. 467 (2006).

7. See LOPUCKI, *supra* note 5, at 231.

8. See *id.* at 207-32.

9. See *id.* at 204-05.

however, may be too late because the plague may already be “global and out of control.”¹⁰

It’s a frightening story. Fortunately, much of it does not appear to be true. A second look at LoPucki’s key findings in *Courting Failure* calls his interpretation of U.S. bankruptcy venue shopping into question. The evidence further suggests that the first hints of regulatory competition in Europe should be applauded rather than condemned.

The centerpiece of *Courting Failure* is LoPucki’s celebrated and much debated finding that nearly a third of the largest corporations that filed for bankruptcy in Delaware in the 1990s later filed for bankruptcy a second time.¹¹ To LoPucki, the refilings, buttressed by his claim that Delaware companies perform poorly after they emerge from bankruptcy, demonstrate a failure of the Delaware process.¹² A closer look at the data, however, suggests that the pattern, if there is one, may stem from differences between the companies that filed for bankruptcy in Delaware and those that filed elsewhere. Companies that would most benefit from a quicker reorganization process chose Delaware, which specialized in facilitating prompt reorganizations.

There is no Delaware in Europe, of course, and my conclusions cannot simply be transplanted directly into the European debate. But many of the same factors that suggest that bankruptcy venue shopping has done more good than harm in the U.S. are also relevant to the venue shopping debate in Europe. In Europe, as in the U.S., regulatory competition is likely to have beneficial effects. Moreover, as in the U.S., a regime that provided added flexibility while insuring that the choice of insolvency regime is determined in advance would prove even more effective.

Part I of this Article analyzes the key empirical findings that drive LoPucki’s analyses and conclusions in *Courting Failure*. Drawing on a more extensive critique co-authored with Ken Ayotte, I argue that Delaware’s repeat filings are

10. *See id.* at 207-32.

11. *Id.* at 97.

12. *Id.* at 116-17.

fully consistent with a model suggesting that many companies should rationally choose a quick workout, rather than a thoroughgoing restructuring of operations. Moreover, once artificial distortions in LoPucki's calculations are corrected, the evidence that Delaware companies performed more poorly than companies reorganized elsewhere disappears.¹³ These findings also may explain the shift in refiling rates (in particular, an increase in refilings by companies reorganized outside of Delaware) starting in 1997, when Delaware was stymied by its inability to hire additional bankruptcy judges and other districts had begun to adopt Delaware practices.

Part II considers the lessons of these findings for Europe. One lesson is that some of the same factors that assure that forum shopping does not have a corrosive effect in the U.S. also offer grounds for optimism in Europe. This is true despite the fact that the overall stakes of forum shopping are much greater in Europe, since Member States have very different insolvency regulations, whereas U.S. bankruptcy judges all apply the same federal bankruptcy law. Part II argues that a better approach would link both corporate and insolvency regulation to a company's choice of domicile. Part II also considers the extent to which the current mismatch between the flexibility European firms have when it comes to corporate regulation, as compared to the more limited options in the insolvency context, will distort European corporate regulation.

I. WHAT DO THE VENUE SHOPPING DATA TELL US?

LoPucki's single most important finding in *Courting Failure*—indeed, the finding that inspired LoPucki's ongoing crusade against Delaware—is his discovery that companies that reorganized in Delaware in the 1990s tumbled back into Chapter 11 at a much greater clip than companies that reorganized elsewhere.¹⁴ “The 30 companies that emerged from Delaware reorganization in the period 1991-96,” as he puts it, “were the reorganizations on which Delaware had made its reputation as the nation's best

13. Kenneth Ayotte & David A. Skeel, Jr., *An Efficiency-Based Explanation for Current Corporate Reorganization Practice*, 73 U. CHI. L. REV. 425 (2006) (reviewing LOPUCKI, *supra* note 5).

14. LOPUCKI, *supra* note 5, at 99-100.

bankruptcy court But by February 20, 2000, nine of those 30 reorganizations had already failed.”¹⁵ LoPucki’s investigation of these repeat filings led to a second finding: Delaware-reorganized companies seemed to perform extremely badly after bankruptcy, whereas non-Delaware reorganizations held their ground.¹⁶ In the five years after bankruptcy, according to LoPucki’s calculations, Delaware-reorganized companies averaged a 9% loss, New York companies lost 3%, and companies reorganized elsewhere averaged a 1% profit.¹⁷ LoPucki hangs all of his conclusions on these two findings (the high refiling rate and large losses suffered by Delaware-reorganized companies).

Based on the two findings, LoPucki concludes that the Delaware judges perverted the bankruptcy process in their effort to attract large, high profile cases.¹⁸ Delaware’s judges bent the rules in order to favor the interests of debtors’ managers and lawyers, and they completely abdicated their responsibility to scrutinize the “feasibility” of a proposed reorganization plan.¹⁹ Delaware, as LoPucki has put it, “would confirm a ham sandwich.”²⁰ “Court competition was not merely eroding the integrity of the courts, it was actually destroying companies.”²¹

What should we make of the two key findings and LoPucki’s ominous conclusion about the effects of bankruptcy venue shopping?

A. What Should the Judges Have Done?

Start with the conclusion that Delaware oversight hastened the demise of many companies that might have survived if the cases had been filed elsewhere. This conclusion implies that there were decisions a non-Delaware judge might have made, but the Delaware judge did not, during the course of the case that made a decisive

15. *Id.* at 100-01.

16. *Id.* at 101, 112.

17. *Id.* at 112-13.

18. *See id.* at 255.

19. *See id.* at 140-45.

20. LoPucki made this statement at a conference at Vanderbilt University.

21. *Id.* at 118.

difference in the company's fate. If we look at the cases LoPucki identifies as evidence of Delaware's failure, it is not obvious what the Delaware court could or should have done differently.²² Spectravision, for instance, filed for bankruptcy due to problems with the technology it used for its pay-per-view movie services.²³ After emerging from bankruptcy, Spectravision switched to a newer technology, but this too proved problematic. Spectravision returned to bankruptcy, and was acquired by a competitor during its second bankruptcy case. Spectravision's problems were not problems that could easily have been prevented by a bankruptcy judge.

When LoPucki was asked at the conference that gave rise to this symposium to name a specific decision that a Delaware judge could have made to save a viable company, he himself could not give any examples. Even with the benefit of twenty-twenty hindsight, most of the companies that refiled do not appear to be companies whose viability would have been preserved by a different bankruptcy judge.

B. Does a Second Chapter 11 Filing Show that the Process Failed?

Turn to the smoking gun, the finding that nine of the thirty large companies that emerged from Chapter 11 in Delaware in the years 1991-96 later landed back in bankruptcy. LoPucki treats this finding as stark evidence of a bankruptcy process gone amok.²⁴ Apart from the dangers of drawing firm conclusions from such a tiny number of cases, do repeat filings even prove that the process has failed?

22. Douglas Baird and Bob Rasmussen have done just this, conducting brief but careful case studies of the companies LoPucki points to as evidence of a failure in Delaware. See Douglas G. Baird & Robert K. Rasmussen, *Beyond Recidivism*, 54 BUFF. L. REV. 343 (2006); Robert K. Rasmussen, *Empirically Bankrupt* (Vanderbilt Univ. Law Sch. Law & Econ. Working Paper Series, Working Paper No. 06-07, 2006), available at <http://ssrn.com/abstract=895547>. Melissa Jacoby argues that the hands off approach taken by most bankruptcy judges is precisely what Congress contemplated when it enacted the 1978 Bankruptcy Code. See Melissa B. Jacoby, *Fast, Cheap, and Creditor-Controlled: Is Corporate Reorganization Failing?*, 54 BUFF. L. REV. 401, 428-30 (2006).

23. For a brief description of the Spectravision saga, see Ayotte & Skeel, *supra* note 13, at 449-50 n.55.

24. See LOPUCKI, *supra* note 5, at 101-03.

Not necessarily. To see why, first consider the distinctive qualities of Delaware bankruptcy in the 1990s. In the 1990s, Delaware was known for prepacks and speed.²⁵ Before Delaware's ascendancy, large Chapter 11 cases often got off to a languid start, followed by a fitful reorganization process that routinely lasted for several years.²⁶ No doubt mindful of the widespread complaints that large cases in the 1980s were costly and overly long, Delaware pioneered the practice of providing swift hearings on so-called first day orders. The first day orders provided for ongoing payment of employees, retention of the debtor's bankruptcy lawyers, use of cash that was collateral for a secured bank loan, and other matters essential to minimizing the disruption of the bankruptcy filing.²⁷ During the case, the Delaware judges stood ready to schedule hearings at a moment's notice. Delaware quickly became the forum of choice for cases such as prepackaged bankruptcies where time was thought to be of essence.

LoPucki initially questioned whether Delaware cases truly were faster than reorganization cases elsewhere.²⁸ But subsequent studies have consistently found a speed differential, and LoPucki himself now recognizes the difference. The question, then, is whether companies would rationally file for bankruptcy in Delaware to take advantage of the faster process, even though a quick, low cost Delaware reorganization might be followed by a second Chapter 11 filing?

25. See Skeel, *supra* note 2, at 27. This does not mean that every Delaware case was fast, of course—just that Delaware generally facilitated a prompter reorganization process than other courts.

26. LoPucki himself offered some of the most important evidence that delay was the biggest problem with Chapter 11 in the 1980s, although his findings suggested that the largest cases were not appreciably longer than large cases before the 1978 Code. See Lynn M. LoPucki, *The Trouble with Chapter 11*, 1993 WIS. L. REV. 729.

27. See, e.g., Marvin Krasny & Kevin J. Carey, *Editors Reply to an Anonymous Letter: Why is Delaware the Venue of Choice for Philadelphia-Based Companies?*, THE LEGAL INTELLIGENCER, Mar. 22, 1996, at 9.

28. Theodore Eisenberg & Lynn M. LoPucki, *Shopping for Judges: An Empirical Analysis of Venue Choice in Large Chapter 11 Reorganizations*, 84 CORNELL L. REV. 967, 983 (1999) (finding "no robust evidence in the pattern of filings or processing times that suggests Delaware offers a more efficient forum for resolving large Chapter 11 cases . . .").

In related work,²⁹ Ken Ayotte and I develop a simple, formal model that assumes companies have a choice whether to conduct a thoroughgoing restructuring of the sort that LoPucki seems to think is essential in all Chapter 11 cases (we call this a Restructuring) or a quicker, less intensive restructuring that adjusts the company's capital structure without restructuring the company's operations (which we call a Workout).³⁰ We further assume that the parties do not know for sure whether the company will prove to be viable after Chapter 11, and that there are three possible future states of the world: Good, Bad, and Medium.³¹ If the Good state materializes, the company will prove viable regardless of whether its bankruptcy was a Restructuring or a Workout; the Bad will lead to failure under either approach, and in the Medium state, the company will be viable, but only if its operations are thoroughly reworked through a Restructuring (either in the initial Chapter 11 case or after a subsequent filing).³²

Based on these quite plausible assumptions, the model suggests that the less costly Workout may prove superior to a more costly but more thorough Restructuring if one or more of four conditions holds true:

1. There is a large cost differential between a Restructuring and a Workout; (The intuition here is that a Workout may be preferable if it saves a great deal of money.)³³

29. Ayotte & Skeel, *supra* note 13.

30. *Id.* at 437-53.

31. *Id.* at 439.

32. Under these assumptions, the parties should choose a Workout if:

$(p_G + p_M)(1 + d) + p_B L - R < p_G + p_M(1 - R) + p_B L - X - L$, where p_G is the probability of the Good state, p_B is the probability of Bad, and p_M is the probability of Medium. The value of the company's current cash flow in the Good state is 1; d is the value of the company's future cash flow, as a result of a full Restructuring, in Medium and Good states; R is the cost of a Restructuring and W is the cost of a Workout (and $W < R$); and X is the amount of losses incurred after bankruptcy in the event a full Restructuring is not undertaken. See *id.* at 438-41. For a detailed description of the model, see *id.* at 438-40. This formula simplifies to: $(1 - p_B)d < (R - W) - p_M R - X$, which is the basis for the conclusions described in the next paragraph. See *id.* at 440.

33. This possibility was previously suggested by several other commentators, and dismissed by LoPucki as "[p]erhaps the most brazen argument put forth on Delaware's behalf." LOPUCKI, *supra* note 5, at 108

2. The losses that occur after the initial reorganization and before the parties learn which state of the world has materialized are small; (If losses will be small, the costs of waiting to see if an intensive restructuring is necessary may be low.)

3. The probability of the Medium state is low; (If the odds are relatively small that a thoroughgoing restructuring will later be necessary, the “option value” of waiting, rather than conducting a thorough Restructuring and running the risk it will prove to have been unnecessary, are high.)

4. The probability of the Bad state is high. (The intuition here is that it may not make sense to conduct a thoroughgoing restructuring if the odds are high that the company will prove unviable even after an intensive Restructuring.)³⁴

The initial model assumes that there are no conflicts of interest, and all of the parties wish to maximize the overall value of the company. In the real world, of course, things are not so simple. A debtor’s managers may wish to avoid a thoroughgoing restructuring, for instance, since they will generally be displaced in a Restructuring. If we add the likelihood that managers will avoid a Restructuring if they can, the model yields another important insight: in order to assure that the company is fully restructured, if necessary, creditors will choose a different amount of debt if the company pursues a Restructuring in the initial bankruptcy, than if it opts for a Workout instead. After a Restructuring, creditors should prefer a relatively small amount of debt, whereas they should set the debt level higher if the initial bankruptcy is a Workout.³⁵

Overall, the model suggests that a bankruptcy court that processes cases more quickly and efficiently than its

(describing the argument put forth by Bob Rasmussen and Randall Thomas, which was later suggested in comments by Jesse Fried, that “Delaware’s refilings were not failures but merely the unfortunate, inevitable by-product of smart risktaking”). The data described in Part I.C below suggest that LoPucki dismissed the argument too quickly. *See infra* Part I.C.

34. Ayotte & Skeel, *supra* note 13, at 440.

35. The higher debt load after a Workout is designed to force the company to engage in a thoroughgoing Restructuring if the Medium state materializes. This is not necessary after a Restructuring because the company’s operations will already have been fully restructured.

peers will tend to attract companies that, on balance, are more likely to fail after they complete their initial Chapter 11 case.³⁶ These companies will tend to emerge with more debt in their capital structure than companies that file elsewhere and undergo a costly Restructuring. These findings suggest an alternative explanation for a series of empirical studies that have shown that prepackaged bankruptcies and out-of-bankruptcy workouts do not reduce a company's debt as much as a full-blown bankruptcy does.³⁷ Although the studies tend to treat the higher leverage as a shortcoming of prepacks and workouts, the model suggests that the high leverage may sometimes be optimal.³⁸ It keeps the debtor on a tight leash and facilitates monitoring by the debtor's bank, lenders, or other creditors.

In short, LoPucki supports his conclusion that the Delaware bankruptcy court failed in the 1990s by pointing to the high refiling rates of companies that reorganized in Delaware.³⁹ The high refiling rate, however, can lead to an alternative conclusion. The model suggests that the high rate of refilings is best explained as a selection effect, with companies that would benefit from a quick, low cost process gravitating to Delaware and with other companies taking their bankruptcy filings elsewhere.⁴⁰

C. *The Performance of Delaware Firms After Bankruptcy*

The analysis thus far offers a very different perspective on—and much more plausible interpretation of—LoPucki's

36. Ayotte & Skeel, *supra* note 13, at 441, 443.

37. See, e.g., Stuart C. Gilson, *Transactions Costs and Capital Structure Choice: Evidence From Financially Distressed Firms*, 52 J. FIN. 161 (1997) (finding that transaction costs discourage debt reductions by financially distressed firms when they restructure their debt out of court).

38. See Ayotte & Skeel, *supra* note 13, at 439 n.24, 450-51.

39. LoPUCKI, *supra* note 5, at 97-121.

40. These conclusions are entirely consistent with Baird and Rasmussen's analysis of the individual cases and suggest that they do not fit LoPucki's claims about pernicious bankruptcy court decision making. See Baird & Rasmussen, *supra* note 22, at 355-62. Baird and Rasmussen emphasize the high percentage of prepacks and prenegotiated cases in Delaware, for instance. See *id.* at 347-48. These are precisely the cases that fit the Workout mode described in the model in the previous section. See *supra* pp. 447-49.

finding that Delaware's Chapter 11 bankruptcy system leads to a high refiling rate for reorganized companies. But it doesn't speak directly to LoPucki's second key claim, which is that Delaware-reorganized companies hemorrhaged cash after they emerged from Chapter 11.⁴¹ Whereas the problem with the first finding is LoPucki's interpretation, the problem with the second claim is the finding itself. Upon further inspection, the finding proves to be a mirage.

The mirage arises from two artificial numbers in LoPucki's calculations. First, when corporate debtors emerge from Chapter 11, they generally use fresh start accounting to account for the adjustments made in Chapter 11. Under fresh start accounting, the difference between the company's estimated market value and the liquidation value of its assets is treated as an intangible asset and amortized over time. Although this "asset" is completely artificial, LoPucki's profitability measure treats its amortization as if it were a real cost, and deducts it from profits.⁴² Second, a large portion of the losses in the Delaware cases stemmed from asset writedowns. These writedowns, which reset the company's accounting when it emerges from bankruptcy, can almost always be traced to the problems that landed the company in bankruptcy, rather than to the bankruptcy process itself. Finally, LoPucki's calculations deduct the interest obligations on the company's debt from the profit calculations.⁴³ This calculation is misleading, however, because a company's debt is irrelevant to its operating profits. Moreover, the calculation is particularly prejudicial to Delaware because Delaware-reorganized companies emerge from bankruptcy with higher leverage than companies that filed elsewhere. If we compare the Delaware reorganized companies that emerged from bankruptcy between 1991 and 1996 to companies reorganized elsewhere, using a measure that corrects for each of these biases, the differences in profitability are insignificant. It turns out that Delaware did not send out leaky ships, as compared to the sleek schooners that emerged from other districts, after all. To

41. See LOPUCKI, *supra* note 5, at 109-10.

42. See Ayotte & Skeel, *supra* note 13, at 445-46.

43. See *id.*

the contrary, Delaware appears to have offered a procedure that fit the needs of the companies that filed there.

D. *The Disappearing Delaware Effect in the Late 1990s*

For companies emerging from bankruptcy starting in 1997, the refiling rates that occupy so much of LoPucki's attention suddenly shifted. Delaware's refiling rate remained high—eleven of the twenty four (46%) companies emerging in the years 1997-2000 refiled—but the refiling rates for other courts skyrocketed.⁴⁴ Four of the six (67%) New York cases that emerged during this period subsequently refiled, and six of the thirteen (46%) cases that were filed elsewhere made a return visit to Chapter 11.⁴⁵ “*Something* must have caused these sudden, simultaneous changes at the end of 1996,” LoPucki marvels, as he surveys the new landscape.⁴⁶ “Yet Congress made no change in the bankruptcy laws during the relevant period and the courts handed down no major bankruptcy decisions.”⁴⁷ What explains the disappearing Delaware effect, and what should we make of it?

The shift in filing rates almost certainly stems in important part from the buffeting Delaware took in 1996 and 1997.⁴⁸ In the summer of 1996, the National Bankruptcy Review Commission released its initial proposal that domicile be removed as a basis for venue.⁴⁹ By early 1997, Delaware District Court Judge Farnan had taken control of the assignment of Delaware bankruptcy cases and the movement to eliminate Delaware venue was steadily picking up steam. Coupled with this was Delaware's inability to do anything about its overcrowded docket. Delaware's success had attracted a large number of cases—too many for its two judges to easily handle. If bankruptcy cases were a matter of state oversight, Delaware could have simply added several new bankruptcy

44. See *infra* note 45.

45. See LOPUCKI, *supra* note 5, at 120 tbl.7.

46. *Id.* at 120.

47. *Id.* at 120-21.

48. See *id.* at 77-93, for a detailed chronicle of these events.

49. See *id.*

judgeships.⁵⁰ But because bankruptcy is federal, Delaware was forced to wait on Congress, which did not give Delaware any new judgeships until new bankruptcy legislation was enacted in 2005. In the meantime, bankruptcy courts in other districts began to adopt some of the practices that Delaware had pioneered, such as prompt approval of first day orders.

It is important to be cautious about the significance we attach to the shift in 1997, given the tiny number of cases involved. But to the extent it reflects a meaningful development, it suggests that Delaware had become marginally less attractive as a venue, and (at least some) other districts were beginning to see cases that were similar to Delaware cases and might previously have been filed in Delaware.⁵¹

Notice that this conclusion is entirely consistent with the model developed in the earlier sections of this Article.⁵² If other courts began to adopt Delaware-like practices in the late 1990s, we might expect some of the cases that would benefit from a Workout rather than a Restructuring to go to other courts, rather than Delaware.⁵³ If they did, we might expect to see more refilings in other courts, not because the process was failing, but because more cases where the optimal strategy might lead to a second filing were being filed outside of Delaware. There also appears to have been a shift in the kinds of cases being filed, with far fewer of the prepackaged cases that constituted a substantial share of the large Delaware cases in the 1990s.

LoPucki, of course, offers a very different diagnosis. In his view, the skirmishes between Delaware and its opponents starting in 1996 “focused the world’s attention on

50. For an argument in favor of permitting the states to regulate corporate bankruptcy, just as they regulate other aspects of corporate law, see David A. Skeel, Jr., *Rethinking the Line Between Corporate Law and Corporate Bankruptcy*, 72 TEX. L. REV. 471 (1994).

51. The recent petitions that were filed elsewhere include many of the largest corporate scandal cases, including Enron, WorldCom and, more recently, Refco. See *In re Enron Corp.*, No. 01-16034 (S.D.N.Y. filed Dec. 2, 2001); *In re WorldCom Inc.*, No. 02-13533 (S.D.N.Y. filed July 21, 2002); *In re Refco Inc.*, No. 05-60006-rdd (S.D.N.Y. filed Oct. 17, 2005).

52. See *supra* pp. 447-49.

53. Similarly, if the most difficult cases tended to go to Delaware prior to 1997, some of these cases may have begun filing elsewhere thereafter.

the loss of cases to Delaware.”⁵⁴ Other courts got on the stick and started copying Delaware’s “methods in order to match Delaware’s attractiveness As Delaware responded by adopting changes of its own, the competition intensified, transformed the bankruptcy system, and ultimately corrupted additional courts.”⁵⁵

The problem with this diagnosis is that the Delaware approach appears far more likely to have been a success than a failure.⁵⁶ If a second bankruptcy filing in Delaware often reflected an optimal decision to opt for a Workout rather than a Restructuring, it is quite plausible that this was also the case for at least some non-Delaware refilers starting in 1997. We would need to examine the cases to know for sure—particularly given that most other courts could not match the Delaware judges’ experience and expertise in big cases. But LoPucki’s assessment of the other courts, as with his indictment of Delaware, makes the mistake of assuming that repeat filings must be evidence that the Chapter 11 process has failed.

II. GLOBAL AND OUT OF CONTROL?: LESSONS FOR EUROPE

Across the Atlantic, Europe is now experiencing its own regulatory competition debate in corporate and insolvency law. These developments are not lost on LoPucki. Indeed, the recent course of EU Insolvency Regulation is “Exhibit A” for LoPucki’s contention that the corruption that began in Delaware seems to have infected Europe as well, and may be spreading throughout the world.

The European debate began with a trilogy of cases that have dramatically increased companies’ ability to choose the corporate laws that will regulate their internal affairs.⁵⁷

54. LOPUCKI, *supra* note 5, at 122.

55. *Id.*

56. As Melissa Jacoby points out, there also is a temporal problem with LoPucki’s claim that Delaware corruption infected the rest of the nation. See Jacoby, *supra* note 22, at 414. Although the increase in refilings by non-Delaware reorganized companies starts in 1997, LoPucki’s anecdotal evidence of efforts by other courts to compete with Delaware is based on events that do not take place until 2000 and thereafter.

57. Case C-212/97, *Centros Ltd v. Erhvervs- og Selskabsstyrelsen*, (Mar. 9, 1999) (Den.), <http://europa.eu.int/eur-lex/lex/LexUriServ/LexUriServ.do?uri=CELEX:61997J0212:EN:HTML>. As noted below, the central holding of *Centros*

As two European scholars recount:

In March 1999, the European Court of Justice's decision in the *Centros* case paved the way for company law arbitrage within the EU, by granting European businesses the right to incorporate in any EU Member State no matter where their business is run and correspondingly preventing Member States from imposing their own corporate law on such businesses, other than under very limited circumstances.⁵⁸

In the wake of *Centros* and a pair of cases that subsequently confirmed its central holding, a large number of companies located in continental Europe have crossed the English Channel to incorporate in England, apparently in large part to evade local minimum capital rules.⁵⁹

European companies have less room to maneuver with insolvency law, but here too there are major developments afoot. In 2000, the EC adopted a new regulation governing insolvency proceedings.⁶⁰ The new regulation contemplates that the main insolvency proceeding will be opened in the courts of the country where a debtor has its "centre of main interests" (COMI), and that secondary proceedings can be initiated in other countries where the debtor has an establishment.⁶¹ The EU Insolvency Regulation lies at the heart of LoPucki's claim that American-style venue shopping may now be poised to go "global and out of

was reaffirmed in the subsequent *Überseering* and *Inspire Art* decisions. See Case C-208/00, *Überseering BV v. Nordic Construction Company Baumanagement GmbH (NCC)* (Nov. 9, 2002) (F.R.G.), <http://europa.eu.int/eurlex/lex/LexUriServ/LexUriServ.do?uri=CELEX:62000J0208:EN:HTML>; Case C-167/01, *Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd.* (Sep. 30, 2003) (Neth.), <http://europa.eu.int/eurlex/lex/LexUriServ/LexUriServ.do?uri=CELEX:62001J0167:EN:HTML>.

58. Luca Enriques & Martin Gelter, *The Relationship Between Creditors and Corporate Debtors: Regulatory Competition and Cooperation Within the EU*, 7 EUR. BUS. ORG. L. REV. (forthcoming 2006).

59. See, e.g., Marco Becht et al., *Corporate Mobility Comes to Europe—The Evidence* (Mar. 12, 2006), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=890512.

60. See Council Regulation 1346/2000, European Union Regulation on Insolvency Proceedings, 2000 O.J. (L160) 1 (EC).

61. *Id.* Article 2 defines "establishment" as "any place of operations where the debtor carries out a non-transitory economic activity with human means and goods."

control.”⁶² The brewing crisis, LoPucki suggests, can be traced to two aspects of the new regulation.⁶³ First, the new provision nudges European insolvency regulation in a more “universalist” direction, displacing the traditional “territorial” approach.⁶⁴ In a universalist insolvency regime, every aspect of an insolvency case is governed by a single set of insolvency laws, even if the company’s assets are located in a variety of different countries.⁶⁵ Under territorialism, by contrast, the laws of each country where a company’s assets are located govern the assets that can be found within that country.⁶⁶ By providing for a main proceeding in one country, rather than separate proceedings of equal status in each of the relevant countries, LoPucki argues, the insolvency regulation adopts a universalist framework, and plants the seed of American-style forum shopping.⁶⁷ “Once the court of an EU country determines for itself that it is the debtor’s home country and declares its own case the ‘main proceeding,’” he warns, “the courts of other EU countries are obligated to recognize it as such.”⁶⁸ If the court rules that it is the appropriate location for the main proceeding, he continues, it will be very difficult to upset that determination, even if it is rather dubious.⁶⁹

The second problem is the COMI standard itself. Although the COMI test is ostensibly designed to pinpoint a single, logical forum for any insolvency proceeding, LoPucki argues that the parties can manipulate the COMI standard

62. See LOPUCKI, *supra* note 5, at 207.

63. See *infra* notes 64-65.

64. LOPUCKI, *supra* note 5, at 214 (“The second universalist victory came in 2000, when the European Union adopted the Regulation on Insolvency . . .”).

65. See, e.g., *id.* at 208 (explaining universalism).

66. The choice between universalism and territorialism has generated a substantial debate in the legal literature. See generally Colloquy: *International Bankruptcy, Empirical Research in Commercial Transactions*, 98 MICH. L. REV. 2177 (2000). In LoPucki’s contribution to the symposium, as in *Courting Failure*, he excoriates the universalism favored by most legal scholars and argues for a territorialist approach. See Lynn M. LoPucki, *The Case for Cooperative Territoriality in International Bankruptcy*, 98 MICH. L. REV. 2216 (2000).

67. LOPUCKI, *supra* note 5, at 214.

68. *Id.* at 215.

69. *Id.*

at will.⁷⁰ “All the case placer need do to forum shop,” he concludes, “is make a plausible argument that the chosen court is the ‘centre of main interests[,]’” based on its registered office, headquarters, location of employees or operations, or assets.⁷¹ “The chosen court will do the rest, pondering the issues and then solemnly concluding that the debtor is indeed correct.”⁷² In short, the universalist approach and the COMI standard give case placers the incentive to seek, and Member States to supply, an insolvency process that favors their interests at the expense of everyone else.

The discussion that follows begins by assuming that LoPucki is right about one thing: the EU Insolvency Regulation makes at least some venue shopping possible. If so, what lessons can be taken from the American experience and applied to the European context? The section that follows points out some of the practical limitations on insolvency venue shopping in the EU, and argues that the more important question in Europe is whether the greater flexibility to choose corporate insolvency law will distort European regulation of corporate law and insolvency. The final section then offers a proposal for addressing the distortions.

A. *Is European Forum Shopping Worrisome?*

Although LoPucki overstates the likely effect of the new EU Insolvency Regulation, as discussed in more detail below,⁷³ he correctly diagnoses the general trend. The orientation of the regulation is indeed universalist, and the COMI standard is imprecise enough to give more than one option as to the location of insolvency proceedings for at least some companies.⁷⁴ What does the analysis of the previous part tell us about the implications of the U.S. experience for the European context?

70. See *infra* notes 71-72.

71. See LOPUCKI, *supra* note 5, at 217-18.

72. *Id.* at 218.

73. See *infra* Part II.B.

74. See, e.g., Horst Eidenmuller, *Free Choice in International Company Insolvency Law in Europe*, 6 EUR. BUS. ORG. L. REV. 423, 430 (2005) (describing the standard as “fuzzy and manipulable”).

Start with the evidence we have seen that bankruptcy venue shopping is not necessarily bad, and in fact can be affirmatively beneficial. In the U.S., corporate debtors flocked to Delaware because of the court's expertise and the speed of the Delaware reorganization process. As we also have seen, the pattern of repeat bankruptcy filings appears to reflect a selection effect, where debtors that would benefit from a prompt Chapter 11 filed their cases in Delaware, while other companies filed in their local district. If this is correct, it suggests that the companies that stayed home, and those that went to Delaware, all may have made the right filing decision.

The first question, of course, is whether we could expect this pattern to be replicated in European insolvency cases. The answer is probably no for the short run, but possibly yes in the mid- or long- term. Delaware's rapid success stemmed in important part from its role as the preeminent state of incorporation. Although bankruptcy is regulated by Congress, corporate law belongs to the states, and companies trust the Delaware brand and the influence of Delaware corporate culture.⁷⁵ In Europe, by contrast, there is no corporate "Delaware" to serve as a focal point for insolvency venue shopping. The closest analogue is England, which has already begun to attract a substantial number of companies whose operations are located elsewhere. Notwithstanding LoPucki's dire warnings, however, there still are questions concerning a company's ability to shift its headquarters to England at the last minute to justify an English insolvency filing.⁷⁶ Moreover, even after substantial recent reforms, the English insolvency rules do not offer much of a carrot for the managers who would need to initiate such a move, nor do the insolvency rules of any of the other major jurisdictions.

The prospect of bankruptcy venue shopping cannot be ruled out altogether, however, which leads us to the second

75. These factors are emphasized in David A. Skeel, Jr., *Lockups and Delaware Venue in Corporate Law and Bankruptcy*, 68 U. CIN. L. REV. 1243, 1278 (2000) [hereinafter Skeel, *Lockups*]; David A. Skeel, Jr., *What's So Bad About Delaware?*, 54 VAND. L. REV. 309, 328-29 (2001) [hereinafter Skeel, *What's So Bad?*].

76. See, e.g., Enriques & Gelter, *supra* note 58 (manuscript at 53, on file with author) (noting that forum shopping is unlikely with firms whose operations are located in only a single country).

issue: are there serious downside risks to the possibility of European forum shopping? The chief danger of permitting companies to choose where to file for bankruptcy, especially at the last minute, is, as LoPucki so colorfully alleges, that the company and its professionals will choose a location that serves themselves but not the other constituencies of the firm.⁷⁷ If the filing location is determined in advance, a company's choice of filing location may be subject to market discipline—the company may be forced to pay a higher interest rate or bear a higher cost of equity capital when it raises money, for instance, if any bankruptcy will be filed in a location that favors managers and lawyers at the expense of the company's other constituencies.⁷⁸ But if the managers and lawyers are permitted to make this choice at the last minute, they will not face the same market discipline. A court or country that wished to attract large scale insolvency cases could therefore invite managers and their lawyers to help themselves to the company's till, without either the thieves or the jurisdictions that love them needing to worry about capital market discipline.

This is the theory. The U.S. reality is quite different. As an account of U.S. practice, especially as it has evolved in recent years, the race to the bottom story ignores a major check on the choice of venue: the debtor-in-possession banks that have come to dominate the governance of the largest Chapter 11 cases.⁷⁹ As most large companies near bankruptcy, they are desperate for cash and turn to existing or outside banks for financing. The bank financiers use the financing agreement to exert substantial control

77. LOPUCKI, *supra* note 5, at 133.

The lawyers and executives who choose venues for large public companies—the case placers—are hard-nosed businesspeople. They know they have something to offer: tens or hundreds of millions of dollars of business for local bankruptcy practitioners. They expect something in return: advantages their bankruptcy courts at home would not give them.

78. This point, and the fact that the U.S. bankruptcy venue rule does not require a prior commitment of this sort, is a major theme of Robert K. Rasmussen & Randall S. Thomas, *Timing Matters: Promoting Forum Shopping by Insolvent Corporations*, 94 NW. U. L. REV. 1357, 1359 (2000).

79. I have discussed this phenomenon at length elsewhere. See, e.g., Ayotte & Skeel, *supra* note 13, at 462-67 (discussing lenders as influence on venue choice); David A. Skeel, Jr., *The Past, Present and Future of Debtor-in-Possession Financing*, 25 CARDOZO L. REV. 1905 (2004).

over the debtor, both before and in bankruptcy. These banks would not simply look the other way while the debtor and its managers filed for bankruptcy in a jurisdiction that favored their interests over those of everyone else. Indeed, the banks themselves often appear to be the ones who make the venue decision.

In Europe, corporate creditors have even more influence in corporate and insolvency law, which suggests that we could expect them to be at least as effective a check on managers' filing decisions as are U.S. lenders. Indeed, creditors currently are the ones who file most European insolvency cases because most European countries have manager displacing insolvency regimes.⁸⁰ It is possible that this will change as European corporate and insolvency laws evolve. But the fact that creditors exert significant control even in the U.S., which has one of the world's most manager friendly bankruptcy regimes, is strong evidence that European insolvency forum shopping is unlikely to degenerate into a race to the bottom of the sort LoPucki predicts.

Rather than the risk of expropriation by managers and their lawyers, the more important concern is whether the most influential creditors will divert value to themselves at the expense of other creditors. In the U.S., this is a concern in some contexts, but overall, creditor control has significantly improved the Chapter 11 process.⁸¹ Creditor influence is likely to have a similarly benign influence on European insolvency law.

There is another reason not to worry about the prospect of European venue shopping. The new EU Insolvency Regulation does not contemplate that the location of the main proceeding will handle the entire insolvency case if some or most of a company's operations are located elsewhere.⁸² Rather, the regulation contemplates secondary proceedings in the other Member States where a company

80. See, e.g., Luca Enriques & Martin Gelter, *How the Old World Encountered the New One: Regulatory Competition and Cooperation in European Corporate and Bankruptcy Law* 67 (2006) (unpublished manuscript, on file with author).

81. See, e.g., Ayotte & Skeel, *supra* note 13, at 464.

82. See Council Regulation 1346/2000, *European Union Regulation on Insolvency Proceedings*, 2000 O.J. (L160) 1 (EC).

has an establishment.⁸³ These secondary proceedings should serve as a significant protection for creditors and other stakeholders in the Member States where the secondary proceedings are set up.⁸⁴

B. *Insolvency Law as a Sub Rosa Source of Company Law?*

Although LoPucki imagines that the floodgates have opened for European insolvency venue shopping, the more salient characteristic of the new EU Insolvency Regulation is the impediments it currently imposes on forum shopping. Whereas U.S. law permits companies to select any state's corporate law and nearly any bankruptcy venue, European companies have much more flexibility in choosing their charter than in picking an insolvency court.⁸⁵ If this mismatch continues,⁸⁶ there are several important implications for European company and insolvency regulation.

First, differential treatment of company and insolvency regulation magnifies the significance of where a provision is located. Lawmakers who wish to attract companies to their country will focus on reforming company rather than insolvency law because company law can be exported. Similarly, lawmakers who wish to prevent companies that are physically located in the country from evading regulatory restrictions can achieve this effect through insolvency regulation.

The most prominent illustration of the potential consequences of whether a provision is located in company or insolvency law is the forum shopping that has emerged with respect to minimum capital rules. Germany relies

83. *Id.*

84. See Armour, *supra* note 4, at 25.

85. The principal limitation in the U.S. stems from federal provision of the bankruptcy laws. A company can choose the state that supplies its general corporate law, and it can choose the location where it files for bankruptcy. But the bankruptcy laws themselves are federal. For an analysis of the distortions this creates, see Skeel, *supra* note 50, at 489.

86. Armour speculates that a company's registered office, its domicile, may increasingly be presumed to be its COMI. Armour, *supra* note 4, at 26-29. Such a presumption would significantly increase the scope for venue shopping, especially if the barriers to companies' ability to shift their registered office midstream also are removed.

heavily on an elaborate system of minimum capital rules in its company law to protect creditors. This means that companies based in Germany can evade the German capital rules by incorporating elsewhere.⁸⁷ On the other hand, if creditor protections are located in a country's insolvency laws, they usually will apply even to companies that move their domicile elsewhere. Thus, England's wrongful trading rules, which are an important creditor protection for English companies, will be much harder to evade because the rules are located in England's insolvency law.

It is too early to tell whether the stickiness of insolvency law will significantly alter European lawmaking. Lawmakers cannot simply designate any provision they wish as an insolvency provision. Provisions that are not limited to the bankruptcy context, for instance, may not be construed as insolvency provisions, and may not be applied, even if they are carefully tucked into a country's insolvency law.⁸⁸ The "relabeling of company law provisions as insolvency law," in the words of two European scholars, "may only work provided that these provisions are properly 'insolvencified,' i.e. so long as a (sufficient) number of features linking them to the insolvency proceeding and its objectives are introduced."⁸⁹ If this proposition is correct, new provisions will only apply if a company does, in fact, land in insolvency proceedings, which will limit the extent to which lawmakers can prevent companies from avoiding local company law rules. Limiting, however, is not the same thing as preventing. To the extent company law is subject to more regulatory competition than insolvency law, the mismatch could distort lawmakers' regulatory focus.

87. This does not mean, however, that troubled Germany-based companies that move their domicile to England can make distributions with impunity. Germany has fraudulent conveyance provisions in its insolvency laws that will apply if these companies enter insolvency proceedings.

88. Provisions that might interfere with a company's "freedom of establishment" are invalidated unless they meet the four part *Gebhard* test. *Gebhard* requires that a provision be (1) nondiscriminatory in its application, (2) required by the public interest, (3) tailored to meet the public interest concern in question, and (4) proportionate in its effect. Case C-55/94, *Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori de Milano*, 1995 E.C.R. I-4165.

89. Enriques & Gelter, *supra* note 58 (manuscript at 51, on file with author).

C. *To Constrain or Unleash European Regulatory Competition*

Notice the irony in the previous section. Although LoPucki warns that the new EU insolvency rule may lead to ruinous forum shopping, the most pressing regulatory issues stem from the comparative difficulty, not the ease, of bankruptcy forum shopping. The parties' ability to choose their company law, but relative inability to opt out of their local insolvency law, creates a sharp cleavage between the effects of company law, on the one hand, and insolvency regulation on the other hand. Should anything be done about the mismatch between the EU's treatment of company and insolvency law?

A response that is consistent with the spirit of LoPucki's conclusions in *Courting Failure* would be for EU decision makers to clamp down on regulatory arbitrage in both company and insolvency law.⁹⁰ This would reinvigorate the traditional territorialism in European company and insolvency law. The country where the company's main operations were located would govern all aspects of its existence. No need to worry about companies picking and choosing the laws that apply to them. This hostility to regulatory competition, however, is problematic for a variety of different reasons. The first is that regulatory competition has made things better rather than worse in the U.S. context. Stifling competition in Europe would cut off the possibility of similar benefits. Second, the dangers of European regulatory competition are quite limited. Even if the regulatory obstacles were removed, charter and insolvency competition would be likely to remain less vigorous in Europe than in the U.S. In the insolvency context, the existence of secondary proceedings in each other Member State where the company has an establishment will limit the scope of the main proceeding. In addition, cultural, language and other differences may encourage many companies to stick with their home jurisdiction both for corporate law and for any insolvency proceeding. Finally, creditors can constrain a company's

90. LoPucki does not explicitly call for federalization of U.S. corporate law, but his dim view of Delaware's preeminence suggests that he would favor, or at the least would be agnostic about, retrenchment on corporate charter competition in the U.S., and by extension, in Europe.

regulatory choices to some extent. A lender that is concerned about opportunistic reincorporation to another Member State could make reincorporation a default under the parties' credit agreement. Although bankruptcy forum shopping is more difficult to constrain, the U.S. experience suggests that creditors will often exert significant influence over a debtor's choice of venue.

Rather than foreclosing regulatory choice altogether, one alternative—in my view a far more promising alternative—would preserve companies' flexibility to opt into a particular nation's corporate laws by domiciling in that nation, but would apply this choice to both corporate law and insolvency regulation.⁹¹ Under this approach, a company domiciled in England would be subject to English insolvency law as well as English company law. For a company domiciled in Germany, both German company and insolvency law would apply.⁹² Linking corporate and insolvency law to domicile would sharply reduce any risk that a company would choose an insolvency regime at the last minute to the benefit of insiders and the detriment of everyone else. The location and source of regulation would be clear because it would be determined by the company's domicile. Treating corporate and insolvency law as a seamless web would also eliminate the regulatory distortions that have been created by the differential treatment of corporate and insolvency law.⁹³

One objection to giving companies a choice of insolvency regimes is that while large creditors can protect themselves, the choice may be used to divert value from tort and other

91. I have argued elsewhere for a similar approach in the U.S. context, suggesting that companies be required to file their bankruptcy cases in their state of incorporation. See Skeel, *supra* note 2, at 37-38; Skeel, *Lockups*, *supra* note 75, at 1275; Skeel, *What's So Bad?*, *supra* note 75, at 327. For an argument similar to the one I make here with respect to EU regulatory competition, see Eidenmuller, *supra* note 74, at 446-47.

92. If the location of a company's registered office were presumptively deemed to be its COMI, this presumption would link corporate and insolvency law in precisely the way I have advocated.

93. By itself, the domicile-based approach does not address the possibility that a company might change venues on the eve of bankruptcy in order to take advantage of another Member State's manager (and possibly shareholder) friendly insolvency regime. As I have noted elsewhere, this concern could easily be addressed by disallowing eve of bankruptcy venue changes. Skeel, *supra* note 2, at 38.

nonadjusting creditors. But value will be diverted from nonadjusting creditors only to the extent that they are both truly nonadjusting and not otherwise protected by the efforts of larger creditors. In practice, nonadjusting creditors can often ride on the coattails of more active creditors. A nonadjusting creditor that is in the same class as larger creditors will generally receive the same recovery, for instance.⁹⁴ Moreover, the existence of secondary proceedings in the nonadjusting creditor's Member State should further diminish any risk of expropriation.

The treatment of employees may seem to be an exception to this sanguine conclusion. This is the aspect of European insolvency regulation that varies most dramatically, with a few countries (like England) providing for very little protection for employees in bankruptcy, whereas others provide much more. The concern here is that a country's insolvency laws may reflect a strong national policy of protecting employees that will be undermined if companies with local operations can domicile elsewhere. Even with this concern, however, there is *less* than initially meets the eye. If the country applied a consistent employment obligation, such as restrictions on laying off employees, to all business operations within the country, it would presumably be honored so long as the obligation were not limited to company or insolvency law. To the extent regulatory arbitrage encouraged lawmakers to adopt generally applicable laws rather than protections that only applied in bankruptcy, this effect could actually improve existing regulation.

It is also important to emphasize the relatively limited scope of regulatory competition. In the U.S., where there are few obstacles to incorporating in one state rather than another, the vast majority of companies incorporate in their local jurisdiction. Only large corporations seriously consider incorporating elsewhere, usually Delaware.⁹⁵ A similar

94. It also is worth noting that tort claims, a major class of nonadjusting creditors in the U.S., are a much smaller factor in Europe.

95. See, e.g., Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Competition or Leisurely Walk: Reconsidering the Competition Over Corporate Charters*, 112 YALE L.J. 553 (2002) (documenting that the choice for incorporation is Delaware or a company's home state); Robert Daines, *The Incorporation Choices of IPO Firms*, 77 N.Y.U. L. REV. 1559 (2002) (again documenting that the choice for incorporation is Delaware or a company's home state).

pattern seems likely to develop in Europe. Some companies, for whom their home jurisdiction's company laws are seriously inefficient, may incorporate elsewhere. But the vast majority of companies can be expected to stay right where they are.⁹⁶

One final issue also warrants mention. In the U.S., differential tax rules play a relatively small role in corporations' choice of corporate domicile, and little or no role in their choice of bankruptcy venue. Federal tax rates are the same, whether a company incorporates in Delaware, New York, or Nevada.⁹⁷ In Europe, by contrast, tax competition figures more prominently, due to significant differences in corporate tax rates. As a result, tax competition may influence corporations' choice of domicile at least as much as, and possibly more than, differences in corporate regulation. Existing tax rules also serve as a drag on charter competition by penalizing companies that change their domicile midstream. Whether these tax effects will continue as lawmakers in countries who are losing corporations respond to the tax competition, and as the tax rules that chill reincorporation are challenged under EU law as interfering with freedom of establishment, remains to be seen.⁹⁸

Either way, the underlying point about corporate and insolvency law remains the same. The current framework, which gives companies increasing flexibility to choose the

96. This is a major theme of Enriques and Gelter, *supra* note 58. See also Luca Enriques, *EC Company Law and the Fears of a European Delaware*, 2004 EUR. BUS. L. REV. 1259, 1265 (noting that cultural and political factors may impede reincorporations in the EU). Enriques and Gelter also argue that Member States do not have a large incentive to compete to attract companies because the potential benefits for any given Member State are comparatively small.

97. Even in the U.S., differential tax rules do come into play for a few companies. The fact that Delaware does not impose a state tax on passive income, for instance, attracts some companies (particularly subsidiaries of a corporate group) to Delaware. Local tax effects also may influence non-U.S. companies' decisions whether or when to incorporate in the U.S. For a discussion of the greater significance of tax effects for incorporation decisions in Europe than in the U.S., see Edward B. Rock, *Taxes and Charter Competition* (2005) (unpublished manuscript, on file with author).

98. For an argument that the tax impediments to reincorporation may be struck down as interfering with freedom of establishment, see Armour, *supra* note 4, at 15-16.

company laws that apply to them, but offers less flexibility with respect to insolvency, appears to be a step in the right direction for EU corporate and insolvency regulation. But the mismatch between corporate and insolvency law could create undesirable distortions. These distortions would be removed if a company's choice of domicile determined both the corporate and insolvency regulation that governed the company.

This solution is directly contrary to the approach LoPucki advocates in *Courting Failure*, which decries the new regulatory competition in Europe and suggests that it should be shut down. Our analysis of the American data suggests that what LoPucki has condemned as problems actually appear to be solutions. Regulatory competition has had beneficial effects in the U.S. Although competition in the European Union is likely to play out differently than its U.S. analogue, the U.S. evidence suggests that competition in the EU should be encouraged, not thwarted.